INFORMATION BULLETIN #72

INCOME TAX

JANUARY 2003

(Replaces Information Bulletin #72 dated June 1993)

DISCLAIMER: Information bulletins are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules and court decisions. Any information that is not consistent with the law, regulations or court decisions is not binding on either the Department or the taxpayer. Therefore, the information provided herein should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein.

SUBJECT: S Corporation/Partnership/Fiduciary Election to File Composite Return On Behalf of Nonresident Shareholders/Partners/Beneficiaries

REFERENCES: IC 6-3-4-12, IC 6-3-4-13, IC 6-3-4-15

An S corporation, partnership or fiduciary may file a composite adjusted gross income tax return on behalf of some or all nonresident shareholders, partners or beneficiaries. Due to the similar treatment of composite returns for corporations, partnerships and fiduciaries, whenever this bulletin mentions "corporation" or "shareholder", it refers to the S corporation/partnership/fiduciary and the shareholder/partner/ beneficiary, respectively. If the nonresident shareholders properly elect to participate in a composite return, they will be relieved of the obligation to file an individual adjusted gross income tax return.

Any shareholder falling within the following categories must, in all cases, be excluded from the composite return:

a) any shareholder that is a corporation, partnership, or fiduciary;

b) any shareholder who received a distribution(s) during the year in excess of his/her distributive share of the corporation's ordinary income;

c) any shareholder who during the taxable year sold any portion of his/her interest in the corporation;

d) any shareholder who received income during the year from an Indiana source other than the corporation;

e) any shareholder who for a portion of the year was a resident of Indiana.

Those shareholders who for any reason are not included in the composite return must file Indiana Part-Year or Nonresident Income Tax Returns (Form IT-40PNR). The names, addresses and social security numbers of these excluded shareholders must be disclosed on the composite return.

The following limitations and conditions shall apply to those shareholders included in the composite return:

a) any short term capital gain (loss) plus any long term capital gain (loss) specifically allocated to partners shall be allowed subject to any "passive activity" loss limitations pursuant to IRC Section 469 and capital loss limitations imposed on noncorporate taxpayers by IRC Section 1211;

b) no deduction shall be permitted for interest paid on investment indebtedness under Section 163(d) of the IRC (limitation on interest investment indebtedness);

c) no deduction shall be permitted for net operating losses;

d) no personal exemptions shall be permitted;

e) no deduction shall be allowed for charitable contributions allowed or allowable pursuant to Section 170 of the Internal Revenue Code;

f) any college credit for individual contributions is limited on the composite return to the lower of each shareholder's state tax liability or $100 (no joint credit with spouse is permitted);

g) no credit is permitted for taxes paid to other states;

h) no credit carryovers are permitted.

i) any refund of state and/or county taxes will be remitted directly to the corporation.

Composite Filing Procedures

1) Send a copy of composite filing procedures for nonresident shareholders to each nonresident shareholder. The corporation must ascertain which shareholders elect to be included in the composite return and which shareholders do not elect to be included.

2) (a) Prepare a comprehensive schedule which sets out the calculation of tax attributable to each nonresident shareholder. Indicate the names, addresses and social security numbers of those individuals included in the composite return. Subject to the exemptions, deductions and credit limitations above, separately compute the Indiana tax liability of each nonresident shareholder who has authorized the corporation to file on his/her behalf. Attach this schedule to the Small Business Corporation Return (Form IT20S), the Partnership Return (Form IT-65), or the Fiduciary Income Tax Return (Form IT-41).

   (b) For a partnership, composite income means each nonresident partner's distributive share of income from the partnership which is derived from sources within Indiana as determined by the use of the apportionment formula described in IC 6-3-2-2(b) on the partnership's income.

   (c) Any limitations imposed on the respective shareholders by Section 469 of the Internal Revenue Code (passive activity loss rules) will apply to the composite return.

   (d) For the beneficiary of a trust or estate, composite income means all distributions subject to Indiana adjusted gross income tax. For further information, see Information Bulletin #1, Fiduciary Income Tax Return.

3) On Form IT-20S, IT-65, or IT-41 enter the total tax liability of those nonresidents included in the composite return. Insert this amount on the line for "other tax" or "additional tax".

4) Insert the total tax withheld on behalf of the nonresident shareholders included in the composite return on the line for "other credits." This amount plus the total tax withheld on behalf of the nonresident shareholders not included in the composite return should conform to the Annual Reconciliation of Withholding (Form WH-3).

5) Attach a second schedule of names, addresses, social security numbers, the individual distributive shares and tax withheld for those shareholders who for any reason were excluded from the composite return.

6) On a monthly or quarterly basis, using Form WH-1 (Employers Withholding Tax Return), submit withholding tax payments on behalf of all nonresident shareholders along with any withholding for corporate employees.

7) File copy A of Form WH-18 (Indiana Miscellaneous Withholding Tax Statement for Nonresidents) with the Department of Revenue together with Form WH-3 (Annual Withholding Reconciliation) by February 28.

   Copy B should be given to the recipient for their records.

   Copy C should be attached to the composite return.

   Copy D is for the payer's records.

   Form WH-3 is mailed automatically to the payer in January.

The corporation filing a composite return for the nonresident shareholders is liable not only for the tax shown on the return but also for any additional tax, interest, and penalty as a result of a subsequent audit and examination.

The composite return shall be due with the corporation return. If the IRS allows the corporation an extension on its federal income tax return, the corresponding due dates for its Indiana income tax returns are automatically extended for the same period, plus thirty (30) days.

For purposes of IC 6-8.1-5-2(a), the return referred to is the composite return for those shareholders properly included in the composite return.

Kenneth L. Miller
Commissioner